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FM AMEMBASSY PRETORIA  
TO RUEHC/SECSTATE WASHDC 0415  
INFO RUCNSAD/SOUTHERN AFRICAN DEVELOPMENT COMMUNITY  
RUCPCIM/CIMS NTDB WASHDC  
RUCPDC/DEPT OF COMMERCE WASHDC  
RUEATRS/DEPT OF TREASURY WASHDC

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DEPT FOR AF/S/MTABLER-STONE; AF/EPS; EB/IFD/OMA  
USDOC FOR 4510/ITA/MAC/AME/OA/DIEMOND  
TREASURY FOR OAISA/RALYEA/CUSHMAN  
USTR FOR COLEMAN

E.O. 12958: N/A

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SUBJECT: SOUTH AFRICA ECONOMIC NEWSLETTER December 9 2005  
ISSUE

11. Summary. Each week, Embassy Pretoria publishes an economic newsletter based on South African press reports. Comments and analysis do not necessarily reflect the opinion of the U.S. Government. Topics of this week's newsletter are:

- Interest Rates Remain Unchanged;
  - October Manufacturing Growth Slows to 0.3%;
  - Moderate House Price Growth Continues;
  - South Africans Abroad Keep Contacts;
  - Business Confidence Still High;
  - South African Teacher Shortage Looms;
  - Competition Commission Found Higher Car Prices but no Legal Case; and
  - SA Wants to be Africa's Services Hub but Finds High IT Costs a Barrier;
- End Summary.

Interest Rates Remain Unchanged

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12. Citing improved inflationary outlook, the Monetary Policy Committee (MPC) decided to leave interest rates unchanged, with the repurchase rate remaining at 7%. Inflation excluding mortgage costs (CPIX) has been declining since August 2005, even with substantially higher petroleum prices. October's CPIX inflation dropped to 4.4% compared to August's inflation of 4.8%. Food, clothing and furniture prices have shown recent declines and even services inflation have been well within the 3-6% target, with October's growth at 5.2%. The MPC now expects CPIX to reach 5% by the end of 2007, compared to 5.3% at the October MPC meeting. In addition, inflationary expectations came in lower compared to expectations at the October MPC meeting. According to the inflation expectations survey conducted by the Bureau for Economic Research (BER), CPIX inflation expectations remain unchanged in 4th quarter 2005 compared to the previous quarter, with inflation expected at 5.2% for both 2006 and 2007. The previous BER survey expected 2007 inflation at 5.4%. The MPC also noted signs of moderating consumer demand, with vehicle sales, manufacturing production, money supply and credit growth all experiencing slowing growth. The MPC cited an increasing current account deficit as the primary risk, although it noted that so far the deficits have been financed by capital inflows. Market expectations thought that the MPC would leave interest rates unchanged in December. Source: Monetary Policy Statement, South African Reserve Bank, December 8; Standard Bank, MPC Alert, December 8.

## October Manufacturing Growth Slows to 0.3%

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¶3. Manufacturing growth slowed to an 18-month low of 0.3% (y/y) in October compared to September's growth of 5.6%, according to Statistics SA. On a monthly basis, manufacturing output fell by 4.9% (seasonally adjusted). Following the latest Investec Purchasing Managers Index (PMI) figures, a leading indicator of manufacturing activity, the outlook for the manufacturing sector remains uncertain in the short term. PMI declined to 50 index points in November, making it the fourth consecutive month it has declined. Growth in manufacturing production has been supported by strengthening domestic demand since late 2003, but as consumer demand growth flattens, the manufacturing sector is once again exposed to exchange rate risks. Domestic demand accounts for 80% of the manufacturing market, and there are indications that the strength in consumer spending may be abating. Borrowing growth slowed to a seven-month low of 19.5% in October as consumers' debt levels increased to a record 62% of disposable income in the second quarter 2005. The rand has strengthened 9.4% since June 2005, leading to recent export decline of 11% in October. The manufacturing sector is the 2nd largest in South Africa (after the service sector), accounting for 16% of the economy. Source: Business Report and Business Day, December 8; Standard Bank, Manufacturing Unpacked, December 7.

## Moderate House Price Growth Continues

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¶4. According to ABSA, nominal house-price growth reached

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14.7% in November, the lowest year-on-year growth since mid-2002, compared to 16.2% in October. The declining growth trend, which started after house-price growth peaked at 35.5% in October 2004, may allow first-time buyers and middle-income consumers to enter the market. This trend could extend strong residential property demand if interest rates remain stable. Standard Bank's residential property report for the last quarter 2005 also confirmed a declining house-price growth trend, saying that according to its home-loan database, house prices grew 21.5% from a peak of 35.5% in November 2004. Source: Business Day, December 6.

## South Africans Abroad Keep Contact

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¶5. Most South Africans living abroad have not completely cut ties with the country, with 77% of them retaining their South African investments, 69% maintaining South African bank accounts, and 32% owning houses, according to the Homecoming Revolution, sponsored by the First National Bank. In addition, 81% of respondents said they intended to return to South Africa in the future. Homecoming Revolution Managing Director Martine Schaffer said the research did not ask about the skills of the respondents, and could not give a breakdown of the sectors likely to benefit from the homecoming. The survey was conducted on a group of 1192 respondents. The survey found that the main reasons for reluctance to return to South Africa were crime (44%), poorer quality of life (20%), affirmative action and black economic empowerment policies (19%), and lack of job opportunities (15%). Source: Business Day, December 6.

## Business Confidence Still High

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¶6. Business confidence remained high in November due to strong domestic demand, and was likely to retain these levels barring a hike in interest rates. The South

African Chamber of Business' (SACOB) business confidence index rose slightly to 126.5 in November, up from 126 in October. The SACOB index has remained stable for the past four months. Over the past 15 months, it has recorded a spread of only six index points between its lowest and highest levels. SACOB economist Richard Downing said the positive financial environment had led to the higher level of business confidence and that low interest rates and low inflation supported confidence remaining high. Plans to increase the economy's growth rate to 6% will have to increase supply potential. The ratio of investment to gross domestic product (GDP) is currently at about 17%, and will need to be above 20% to achieve sustainable 6% economic growth. Source: Business Day, December 7.

#### South African Teacher Shortage Looms

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17. South Africa faces a teacher shortage at a time when pupil numbers are increasing, according to Mary Metcalfe, head of the University of Witwatersrand's School of Education. South Africa will have few teachers in the 30-34 age group and fewer than 20,000 aged 35-39 due to a 12.7% HIV prevalence rate among teachers, up to 21,000 South African teachers leaving the profession, and upcoming retirements. Metcalfe asserted that South Africa should have 25,000 teachers qualifying each year compared to the 5,000 teacher qualifying currently. South Africa's Department of Education has stated that there is no teacher shortage, as there are enough unemployed or underemployed teachers to avert any shortage. Source: Business Day, December 7.

#### Competition Commission Found Higher Car Prices but no Legal Case

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18. The Competition Commission found that car prices in South Africa were higher, but did not find justification for legal actions against car manufacturers, as the companies were not defined as dominant players according to South Africa's competition law. The 18-month-long investigation into excessive pricing showed that cars in South Africa cost about 14% more than in Europe. The

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Commission announced, however, that it had entered into settlement agreements with six car makers and importers relating to earlier investigations into collusion and minimum resale pricing in the industry. General Motors (GM), Nissan, DaimlerChrysler, Citron, Volkswagen and its Gauteng dealers, along with Subaru, would pay a collective administrative penalty of R31.6 million (\$5 million, using 6.5 rands per dollar). By accepting settlement agreements, these companies avoided further investigation and possible prosecution by the Competition Tribunal. The Commission has also found evidence of anticompetitive behavior by BMW, but said it was still negotiating with the company. Much of the Commission's findings in its investigations related to a high level of control car makers have over dealerships. The National Automotive Dealers' Association welcomed the Commission's requirement that car makers that had entered into settlement agreements had to review dealer franchise agreements. Source: Business Day, December 8.

#### SA Wants to be Africa's Services Hub but Finds High IT Costs a Barrier

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19. South Africa has been trying to position itself as the business services hub on the continent, but high telecommunications costs and skills shortage have constrained local service providers from competing successfully in the global market, according to Raymond Ngcobo, the head of the Strategic Competitiveness Unit in

the Department of Trade and Industry (DTI). Over the next three years, Ngcobo said the government would give priority to business process outsourcing, financial services, tourism and construction as these sectors had the potential to create jobs. As part of the plans to accelerate growth to a sustainable 6% by 2010, the DTI was drafting a services strategy that would address bottlenecks such as exorbitant telecoms costs and infrastructure-related constraints. Between 2000 and 2004, global trade in services grew by 8.5% despite the tight regulation of the market by many countries. Source: Business Day and Business Report, December 8.

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